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THE FINANCE ACT INTRODUCTION OF “SIGNIFICANT ECONOMIC PRESENCE” TO THE COMPANIES INCOME TAX ACT 2004 AND SIGNIFICANT ECONOMIC PRESENCE ORDER 2020: AN OVERVIEW OF THE IMPACT ON CROSS BORDER TRANSACTIONS

Introduction

The concept of SEP was recently introduced into Nigerian Tax Jurisprudence and can be described as a system of tax administration geared toward the capture of online and digital transactions between Non-Resident Companies (NRCs) and persons resident in Nigeria. Prior to the advent of SEP, NRCs were only taxable in Nigeria when they had a fixed base or permanent establishment¹ in Nigeria to the extent that their profits were attributable to the fixed base. This established model for determining the scope of Nigeria’s tax jurisdiction has since been shown to be inadequate in the face of the deep penetration and prevalence of online/digital transactions in the Nigerian business space, the implication of which is the ability of NRCs to carry out business with persons in Nigeria without any kind of physical presence within the country whatsoever. The result, from government’s perspective, is a loss of revenue from the profits that accrue to the NRCs over which the government should enjoy taxing rights.

This reality has driven the government to put in place legislations i.e., amendments to the Companies Income Tax Act (CITA) via the Finance Acts (2019 & 2020)



and the subsequent issuance of the Companies Income Tax (Significant Economic Presence) Order 2020 aimed at plugging into this erstwhile untapped revenue stream, the most relevant of which will be examined in the paragraphs that follow.

Legal Framework of SEP in Nigeria

The first mention of SEP was in the Finance Act 2020, an Act of the National Assembly. Section 4 of the Finance Act 2020, which amends section 13 of CITA² provides in subsection (2)(c):

- (2) *The profits of a company other than a Nigerian company [an NRC] from any trade or business shall be deemed to be derived from Nigeria*
- (c) *if it transmits, emits or receives signals, sounds, messages, images or data of any kind by cable, radio, electromagnetic systems or any other electronic or wireless apparatus to Nigeria in respect of any activity, including electronic commerce, application store, high*

¹ Section 13(2)(a) & 45 Companies Income Tax Act (CITA) Cap C21 LFN 2004 and Double Taxation Agreement

² This section, titled “Nigerian Companies” deals with the parameters that define taxability in Nigeria and what entities are liable to tax.

frequency trading, electronic data storage, online adverts, participative network platform, online payments and so on, to the extent that the company has significant economic presence in Nigeria and profit can be attributable to such activity”.

A quick perusal of the above provision reveals the lawmaker’s intention with respect to what sort of activity falls under the scope of SEP. The inclusion of such activities ranging from electronic commerce and online payments to electronic data storage, is indicative of the intention to cover the entirety of the digital business if profit is attributable to those activities and the company involved therein has significant economic presence in Nigeria (a criterion that is expanded upon in subsidiary legislation discussed below).

The law does not stop at digital services however, it widens its scope to cover the provision of technical, professional, management or consultancy services to persons resident in Nigeria as well. Section 4 of the Finance Act 2020 creates a new paragraph (e) under section 13(2) and provides that the profits of an NRC from any trade or business shall be deemed to be derived from Nigeria;

(e) if the trade or business comprises the furnishing of technical, management, consultancy or professional services outside Nigeria to a person resident in Nigeria to the extent that the company has significant economic presence in Nigeria

For the purpose of determining what amounts to a SEP in Nigeria, the law provides in Section 13(4) CITA (as

amended) that:

(4) For the purpose of subsection (2)(c) and (e), the Minister may by order, determine what constitutes the significant economic presence of a company other than a Nigerian company

A combined reading of the above cited provisions of CITA (as amended) form the entirety of the SEP regime in Nigeria. Subsection (4) of the CITA (as amended) vests the power to do so on the Minister of Finance of the Federation. In the exercise of this power, the Minister published the Companies Income Tax (Significant Economic Presence) Order, 2020 (SEP Order).

The SEP Order provides, with specificity, what amounts to the creation of a significant economic presence in Nigeria. In Order 1 of the SEP Order, an NRC shall have SEP in Nigeria in any accounting year if it falls within the following criteria;

- (d) It derives a gross turnover or income of more than N25 Million or its equivalent from any combination of the following activities.*
 - *Streaming/download of digital content, including music, videos, etc.*
 - *Transmission of data collected from Nigerian users of websites or mobile applications,*
 - *Provision of goods and services through a digital platform to Nigeria*
 - *Provision of middle-man services through a digital platform that links suppliers to customers in Nigeria*
- (e) It uses a Nigerian domain name (.ng) or registers a*

website in Nigeria;

(c) It has an intentional and sustained interaction with persons in Nigeria by customizing its digital platform to cater for persons in Nigeria, such as reflecting prices of goods in Naira, for example.³

Sub-order (3) of the SEP Order further provides that any NRC covered under a multilateral tax agreement addressing digitization of the economy to which Nigeria and its home country are signatories will prevail over the provisions of the SEP order.⁴

Order 2 of the SEP Order addresses the second ambit of SEP’s scope in Nigeria, and provides that for the purpose of section 13(2)(e)⁵ of CITA (as amended), an NRC carrying on a trade or business in Nigeria comprising the provision of technical, management, professional or consultancy services in any accounting year where income is earned or payment is made from a person resident in Nigeria, or a fixed base or agent of a company, other than a Nigerian company in Nigeria shall be deemed to have SEP in Nigeria⁶. This section of the law also includes services of a specialized nature such as “advertising services, training, or the provision of personnel”⁷. Withholding Tax on the income of an NRC that falls within this second ambit of the law shall be the final tax as long as the provisions of subsection (2)(a)-(e) CITA (as amended) do not apply as well.

³Order 1(a) of the Companies Income Tax (Significant Economic Presence) Order, 2020 (SEP Order)

⁴ Order 1(3) SEP Order

⁵ Provision of the CITA that covers taxation of technical and professional services etc. provided to Nigerian entities.

⁶ Order 2 of the SEP Order

⁷ Order 2(2) SEP Order

Global impact of SEP on Cross-Border

Nigeria currently ranks as one of the top attractors of Foreign Direct Investment (FDI) in Africa. According to the FDI Intelligence and EY Africa Attractiveness Report, 2019, Nigeria is placed fourth with around 8 Billion USD invested over 65 projects in the course of the year. It stands to reason that the proliferation of digital technology in the global economy will be, and indeed is, a driver of even greater foreign participation in the Nigerian Economy. It is for this reason that the impact of the SEP regime on the business activities of NRCs in Nigeria cannot be overemphasized. A few of these consequences are discussed in the paragraphs that follow.

It is important to take note of the special place that NRCs from countries with which Nigeria might be party to a bilateral/multilateral agreement or treaty occupy within the SEP scheme. Order 1(3) of the SEP Order provides that:

(3)Notwithstanding the provisions of sub-paragraph 1 of this paragraph⁸, any company, other than a Nigerian company, covered under a multilateral agreement or consensus arrangement to address the tax challenges arising from the digitization of the economy, to which Nigeria is a party, shall be treated in accordance with that agreement or arrangement”

The wordings of the above section envisage the application of international agreements on the administration of SEP in Nigeria and makes provision for same. In fact, talks are currently ongoing in the Organisation for Economic Cooperation and Development (OECD) on the development of a Base Erosion and Profit Shifting

(BEPS) Action plan to determine taxing rights under the SEP regime. No consensus has been reached, however, as parties have not been able to come to an agreement on the burning issues⁹. Sub-order (3) above merely creates an avenue for such an agreement to apply if it ever comes to fruition.

In the same vein, Nigeria is currently party to fourteen (14) DTTs that have been ratified and incorporated into local law; these countries include Canada, France, Pakistan, Belgium, Romania, etc. The taxation of NRCs from these countries is governed both by local law and the provisions of these DTTs. Where the provisions of a local law conflict with those of a subsisting DTT, the provisions of the DTT must prevail over that of the local enactment – this is based on the doctrine of superiority of international treaties. The aforementioned provision of the SEP order appears to be in accordance with this doctrine as it subjects itself to any multilateral treaty that might be brought into force with relation to the digitization of the economy. It can be expected that, going forward, such an agreement might be incorporated into the currently subsisting DTTs Nigeria is currently party to.

The enforcement of the SEP is expected to come with the obligation for NRCs to register in Nigeria for tax purposes and file annual returns with the relevant tax authority whether or not a physical presence exists in Nigeria. Responsibility around SEP in Nigeria also extends to Nigerian businesses and fixed bases in Nigeria that transact business with affected NRCs as they will be required to account for Withholding Tax (WHT) on payments made to affected NRCs where they apply.

The enforcement of the new SEP regime does not come without its own challenges which ranges from the practical to the administrative. We have identified a few of these challenges as follows:

1. **Administration of Taxing Rights.** For the SEP regime to be effectively and beneficially administered in Nigeria, an administrative framework which addresses the determination of taxing rights, mode of tax collection, and the logistics of tackling the more technical and practical challenges that might arise is required. The SEP Order does not contain any of these modalities neither does it refer to any suitable action plan that might ensure the efficient and successful administration of the SEP regime. Without the appropriate measures being put in place, as expressed above, the SEP regime might fail to achieve its noble objectives in the long term.
2. **The Commencement date vs. The Publication date:** The SEP Order has a commencement date of 03 February 2020, even though it came into public consciousness on 29 May 2020. A failure to address this anachronism might subject Nigerian companies to obligations to account for Withholding Tax on transactions completed before the Order became public knowledge. It is trite that a law cannot be enforceable against a person where the law has not been available for public use. It will amount to retrospective application of the law in such an instance. It is entirely possible that an attempt by the tax authorities to enforce the SEP regime based on the date on the body of the SEP order might lead to disputes between the tax

⁸ Order 1(1)(a) SEP Order

⁹ One of two pillars that form the structure of the BEPS Action plan currently under negotiation at the OECD

authorities and affected taxpayers which might ultimately lead to litigation. It is expected that an operational date should be published to guide affected companies and aid proper compliance.

3. **Remedies available to affected taxpayers:**

The reliance of the SEP regime partly on the existence of a bi/multilateral international agreement raises concerns bordering on the avenues available to NRCs that originate from countries or jurisdictions that do not have a subsisting bi/multilateral agreement nor a DTT with Nigeria.

- a. NRCs from such countries might opt to take advantage of the **Dispute Settlement Body (DSB) of the World Trade Organisation (WTO)** accessible by member states of the organisation. The DSB has jurisdiction to hear matters involving both direct and indirect taxation and may be instituted by the agency of government that the NRC is registered against the government of the taxing authority.
- b. NRCs may also choose to settle their grievances through the apparatus of the **International Center for Settlement of Investment Disputes (ICSID)**. The ICSID has the jurisdiction to hear matters relating to investment disputes, which include taxation, as long as the parties to the matter are signatories to the ICSID Convention. Such an action would also need to be instituted by the Government of the NRC against the Government of the taxing authority, as in this case, Nigeria.

As earlier stated, negotiations are still ongoing at the OECD surrounding the implementation of SEP Policy as no consensus has

yet been reached on BEPS Action 1 which is supposed to be the standard for SEP taxation. Regardless, the Nigerian Federal Ministry of Finance has opted to forge ahead with the promulgation of the SEP Order rather than waiting for the outcome of the ongoing negotiations like other countries, such as India. The provision of Order 1(3) of the Order seems to leave open a space to be filled by the BEPS Action 1¹⁰ policy when an agreement is finally reached, but until then, the Order will apply as enacted.

The drive to begin the taxation of digital services has not gone without resistance from certain quarters. However, the United States of America¹¹, for instance, has been vocal about its dissatisfaction with the SEP model which would seek to tax the income of its large and profitable digital technology (DigiTech) companies, going as far as threatening retaliatory tariffs on European nations that purport to levy digital taxes on its DigiTech companies. It has decried these proposed tax measures as discriminatory against US companies and has effectively halted negotiations with the OECD to come to an agreement on an equitable approach to digital taxation.

This sort of attitude, at least until a consensus is reached by the OECD on how digital services may be assessed and taxed, might affect the implementation of the SEP regime in Nigeria. Issues of non-cooperation will likely arise, as well as retaliatory policies against Nigeria by the countries from which affected NRCs originate. If the SEP regime is to be successful and beneficial to the Nigerian economy, proactive steps must be taken by the Nigerian government in negotiation with the international community to address their concerns and develop fair and practical solutions to the pain

points that will inevitably surface during the regime's administration. It is also likely that, in the interim, there will be a lot of litigation between the Nigerian tax authorities and affected NRCs bordering on the determination of the legality of taxing rights, and obligations sought to be placed on affected NRCs.

Conclusion

Digital technology and the business ecosystem built around it has continued to grow in leaps and bounds over the course of the last decade, and systems of tax administration are in a race to catch up. It is commendable that the Nigerian government has joined other countries by taking strong steps to keep up with the times, but a lot more than lip service needs to be paid to the SEP regime if it is to achieve its objectives.

- 1. Talks, for instance, must be had with stakeholders to reach a resolution on the fine points of this new regime that might become bottlenecks in the process, if not addressed.
- 2. Tax authorities must also work on effective methods of registration and compliance that encourage cooperation for affected NRCs.

The evolving taxation of the digital economy could significantly impact the financial performance of international technology businesses. Explorers Legal Practitioners (ELP) is well positioned to help clients identify the myriad ways in which SEP based taxation might affect them, protect their rights, and help scale any legal and regulatory hurdles they might face under this new regime.

¹⁰ <http://www.oecd.org/tax/beps/beps-actions/action1/>, Action 1 – Tax Challenges arising from Digitalisation (2015 till date)

¹¹ In a letter sent by the United States Treasury Secretary, Steven Mnuchin to four European Finance Ministers (UK, France, Italy & Spain)

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